

No. 14,879

United States Court of Appeals  
For the Ninth Circuit

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BANK OF AMERICA NATIONAL TRUST  
AND SAVINGS ASSOCIATION, as Exec-  
utor of the Last Will and Testament  
of Thomas McDonough, deceased,

*Appellant,*

VS.

UNITED STATES OF AMERICA,

*Appellee.*

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APPELLANT'S REPLY BRIEF.

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**APPELLANT'S REPLY BRIEF.**

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Before answering the arguments of the Government, certain facts, especially with respect to the factors required to be used in computing the deduction for property previously taxed under Section 812(c) of the Internal Revenue Code of 1939, must be emphasized, and the particular issues involved in this case pinpointed.

On page 4 of its brief the Government states:

“The net value of the jointly owned property to which Thomas succeeded by virtue of Peter’s death was \$373,910.01. Such figure was the result of subtracting the figures listed in this paragraph from Peter’s gross estate of \$638,673.66.”

The mathematical computation referred to is—

Peter's gross estate .....		\$638,673.66
Less:		
Federal Estate Tax .....	\$149,289.84	
State Inheritance Tax .....	49,263.81	
Allowable deductions		
{ Debts .....	\$13,633.49	
{ Admin. exp. ....	13,460.04	27,093.53
		<hr/>
(R. 40)		
Specific Legacies .....	39,116.47	
		<hr/>
Total reduction .....		264,763.65 <sup>1</sup>
		<hr/>
Net .....		\$373,910.01

Peter's interest in the joint tenancy property was included in the above gross estate figure of \$638,673.66 at a value of \$577,971.92.

The Government's conclusion is correct as a matter of mathematical computation, but it is not correct as a legal conclusion or statement of fact.

Under California law, joint tenancy property is not part of the probate estate and therefore is not subject to the debts and expenses of the estate. (*Estate of Fritz* (1933), 130 C.A. 725, 20 P.(2d) 361; *Estate of Dow* (1947), 82 C.A.(2d) 675, 679-680, 186 P.(2d) 977; *Estate of Gurnsey* (1918), 177 C. 211, 170 Pac. 402; *Ziegler v. Bonnell* (1942) 52 C.A. (2d) 217, 126 P.(2d) 118). The share of the joint tenancy property acquired by the surviving joint tenant upon death of a joint tenant is chargeable by specific statutory pro-

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<sup>1</sup>Only the item of \$27,093.53 out of this total was allowed or allowable as deductions from the gross estate in determining Peter's net taxable estate.

vision for unpaid inheritance tax imposed upon that "transfer" and also federal estate tax. (California Revenue and Taxation Code Sections 14301, 14121 and 14143, as to California Inheritance tax; California Probate Code Article IV(a), Section 975, and Section 827 Internal Revenue Code of 1939, relating to Federal Estate tax.)

The California Probate Code specifies the order in which estate assets are to be used in payment of estate expenses and charges, as follows:

- (1) Expenses of Probate Administration
- (2) Funeral expenses
- (3) Debts having preference by laws of the United States
- (4) Expenses of last illness
- (5) Family allowance
- (6) Wages up to \$200, etc.
- (7) Mortgages and other liens in order of priority
- (8) Judgments against decedent during lifetime
- (9) All other demands.

(Section 950, Probate Code excepting the insertion of Item 3 above which is based upon judicial decision—*Muldoon Est.* (1954), 128 C.A.(2d) 284, 275 P.(2d) 597. Each of the above classes must be completely satisfied before the next class is entitled to any payment. *Stambach v. Emerson* (1902), 69 P. 856.)

It is obvious that under California law the Government is wrong in its conclusion (pp. 10-11 of its brief)



that assuming Peter's gross estate exceeded the value placed on his share of the jointly owned property by only \$60,701.74, "the remaining taxes and charges amounting to \$204,061.91 would normally have been paid out of what was left in Peter's estate, namely, his share of the jointly owned property". The estate balance would have been applied first to payment of the deductible administration expenses (\$27,093.53) and then to the taxes, and the unpaid balance of the taxes would have been chargeable against the joint property. The specific legacies are not charges against the jointly owned property. Whatever the unpaid balance chargeable against the joint property might be, those charges are allowable deductions in the Estate of Thomas (Sec. 812(b)(4)) and the only items so recognized and allowed as deductions in computing the estate tax against Thomas' estate was the unpaid federal estate tax item of \$141,592.71. If the Government is now arguing that the charges against the jointly owned property were \$204,061.91, it should be ready to concede that additional deductions are allowable to the Estate of Thomas for the difference between the \$204,061.91 and the amount of \$141,592.71 actually allowed.<sup>2</sup> The fact is, however, that the only unpaid

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<sup>2</sup>In the computation of the property previously taxed deduction the Government determined that the identified fair market value in the Estate of Thomas of the property previously taxed in Peter's estate was \$585,719.23 which the Government then reduced by the federal estate tax of \$141,592.71 to arrive at \$444,126.52 as its conclusion as to the property previously taxed included in Thomas' gross estate. (R. 63, line (a), R. 61.) This is not consistent with the Government's contentions that the only previously taxed property acquired by Thomas was \$373,894.78. The Government's contentions are at variance with its own computations, with the stipu-



amount which constituted a charge against the property was the unpaid federal estate tax of \$141,592.71.

In this case the District Court found that

“Although on the date of death of Thomas McDonough all of the jointly owned property included in the prior estate, except the aforesaid item of property valued at \$23.30, was identifiable in the estate of Thomas McDonough, such property was subject to the lien of unpaid federal estate taxes of the prior estate attributable to such jointly-owned property in the sum of \$141,592.71”.

There is no finding that any other amounts were liens or charges against the property, and no other amounts were claimed as deductions on the estate tax return of Thomas. If there were any other amounts which were charges against the property, as the Government now infers, then they would have been so reported on the estate tax return, or the Government would have allowed them as additional deductions when the return was audited by the Revenue Agents. The true answer is, as the District Court in effect found to be the fact as established by the record, that the only charge against the jointly owned property in Thomas' estate was the only unpaid item of federal estate tax of \$141,592.71 against Peter's estate.

Since the joint tenancy property is not chargeable for any of the debts and expenses of Peter's estate,

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lation which is consistent with the above referred to computation (R. 24, 77, 78), and with the requirements of Section 812(c) as to the factors to be used.

excepting the taxes, and since the finding of the District Court and the audit of the Estate Tax Return by the Revenue Agents, indicate that the only charge against the joint tenancy property acquired by the surviving joint tenant was the unpaid federal estate tax of \$141,592.71, it necessarily follows that the net value of the jointly owned property to which Thomas succeeded by virtue of Peter's death was the value of Peter's interest therein of \$577,971.92 less the only item charged against it of \$141,592.71 for federal estate tax, or a net of \$436,379.21, and not the amount of \$373,910.01 as claimed by the Government.

Although it is important to the *ultimate* determination of the deduction for property previously taxed, as will hereinafter be discussed in connection with the application of the fourth paragraph of Section 812(c), the "*net value* of the jointly owned property to which Thomas succeeded" is immaterial to, and not a factor specified in, Section 812(c) in determining the *initial identifiable value* of the property previously taxed. It is the determination of the initial identifiable valuation which is primarily the issue in this case. The prescribed factors to be used in making such determination are clearly expressed in the language used in Section 812(c).

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#### FACTOR 1.

The first factor prescribed in Section 812(c) of the Internal Revenue Code of 1939, as the allowable deduction for property previously taxed, is "the amount finally determined as the value of such property in

determining the gross estate of such prior decedent \* \* \*".

It is stipulated in this case that the value of the jointly owned property acquired by the present decedent from the prior decedent was included in the gross estate of the prior decedent at an amount finally determined to be \$577,971.92 (R. 23, 40, 76). However, the Government's contention, sustained by the District Court, is that this figure should be \$373,894.78.

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#### FACTOR 2.

The second factor limits the first factor "to the extent that the value of such property is included in the decedent's gross estate," thus providing, in effect, that the lesser of the two factors shall be the allowable deduction for property previously taxed.

It is stipulated that "*the gross value of the property jointly owned by Peter F. McDonough and Thomas McDonough included and identified in the Estate of Thomas McDonough at the date of his death as having been received by him from the said Peter F. McDonough without taking account of the proportionate amount of the federal estate tax in the Estate of Peter F. McDonough attributable to said jointly-owned property was the sum of \$585,719.23*". (R. 24, 77, 78).

This gross value of \$585,719.23 is the amount which is properly includible in Thomas McDonough *gross estate* notwithstanding that on the estate tax return for said estate the liability for federal estate tax

against the estate of Peter McDonough of \$141,686.05<sup>3</sup> was erroneously netted against the \$585,719.23 and only the net of \$444,033.18<sup>3</sup> reported as “gross estate.” The \$585,719.23 should have been reported as part of the gross estate, and the \$141,686.05 lien against the property for the tax liability should have been shown amongst the deductions. (See Appellant’s opening brief, pp. 17-19). However, the Government’s contention sustained by the District Court, is that the gross estate valuation of the property in the estate of Thomas is the net amount of \$444,126.52.

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**FACTOR 3.**

The third factor is the factor for adjustments required by the fourth paragraph of Section 812(c), and it has been stipulated that these adjustments will be made by the parties hereto after the issues involved are decided (R. 24).

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**ISSUE WITH RESPECT TO FACTOR 1.**

Page 63 of the Record contains a schedule marked Exhibit A, showing how the Government computed the deduction for the property previously taxed, and showing the Government’s determination of the factors hereinabove discussed as Factors 1 and 2.

Line (b) of the schedule on page 63 of the Record, shows as “Gross PPT (property previously taxed)

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<sup>3</sup>Corrected by Government audit to \$141,592.71 and \$444,126.52, respectively.



\$373,894.78", and by asterisk refers to the schedule on page 65 of the record showing how the \$373,894.78 is computed. This schedule on page 65 shows that the \$373,894.78 is nothing more than a calculation of Peter's gross estate less the aggregate of deductions, federal estate taxes, inheritance taxes and specific legacies (see Record p. 40 showing the Government's final determination of Peter's gross estate and net estate), and the Government then calls this the "Theoretical balance of property previously taxed in present estate" and "identified property previously taxed". It should be noted from Record page 40 that the jointly owned property is shown as included in Peter's *gross estate*, as stipulated, at \$577,971.92.

This, then, pinpoints the issue with respect to Factor 1—does the requirement in Section 812(c) that the deduction in the present decedent's estate (Thomas) for property previously taxed shall be the amount at which such identified property was included in the *gross estate* of the prior decedent (Peter), refer to the amount at which the property was included in Peter's gross estate (\$577,971.92), or does it refer to some "theoretical balance" which is in effect Peter's net estate less inheritance taxes and legacies (\$373,894.78), as claimed by the Government?

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#### ISSUE WITH RESPECT TO FACTOR 2.

Line (a) of the schedule on page 63 of the Record shows as "Total of P.P.T. (property previously taxed) included in gross estate (of Thomas) \$444,126.52".

This was arrived at by deducting from the gross value of \$585,719.23 the property previously taxed, the federal estate tax liability on the estate of Peter of \$141,592.71 (R. 61).

This then pinpoints the issue with respect to Factor 2—should the property be included in the gross estate of Thomas at its fair market value of \$585,719.23, as contended by Appellant, or at such value of \$585,719.23 less the liability for estate tax of \$141,592.71 against Peter's estate, as contended by the Government?

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#### DISTRICT COURT'S CONCLUSION.

The District Court, without discussion of particular factors, used the \$373,894.78 as the limitation on the initial identifiable value of the property previously taxed on the findings that

“The net value of the said jointly-owned property to which Thomas McDonough succeeded by virtue of the death of Peter McDonough was \$373,910.01, computed by deducting from the gross estate of Peter P. McDonough the specific legacies, the federal estate taxes, the state inheritance taxes and the deductions in the amounts set forth above.” (R. 76.)

and

“This left a net adjusted value of the interest of Thomas McDonough in the jointly-owned property included in the prior estate and included in Thomas McDonough's estate to which interest

Thomas McDonough succeeded on Peter P. McDonough's death of \$373,894.78." (R. 77.)

Neither the Government's theory of a "theoretical balance" nor the District Court's conclusion as to the "net adjusted value", are even mentioned in Section 812(c) as factors or tests for the determination of the deduction for property previously taxed, so the District Court's decision based on these particular findings has no support from the Statute and is in fact in direct conflict with the requirements of the Statute as to the factors which must be used in determining the property previously taxed deduction.

The District Court did make findings as to the Section 812(c) factors—that is, that the identified property was included in the gross estate of the prior decedent at a value of \$577,971.92 (R. 76) (Factor 1), and that the fair market value (which Appellant contends means the "gross estate" value) of the identified property in the estate of Thomas was \$585,719.23 (\$444,033.18 plus \$141,686.05—R. 77 and 78) (Factor 2), so, on the basis of these findings the Court should have concluded that the deduction for property previously taxed, under Section 812(c), before adjustments required by the fourth paragraph of Section 812(c), was \$577,971.92, the lesser of the two factors.

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**ARGUMENT IN REPLY TO APPELLEE'S CONTENTION  
AS SET FORTH IN ITS BRIEF.**

Appellant strongly urged that Section 812(c) clearly describes the factors to be used and the method



of their application so there is no occasion or legal authority for digression into far-off fields of theory to support a course of action in direct conflict with the clear wording of the statute.

The Government's entire argument is really set forth in footnote 3 on page 8 of its brief to the effect that Thomas did not inherit the full value of the joint property acquired upon Peter's death, but inherited only the net equity after reducing the full value by the charges against the property, and therefore it is only the net equity which under Section 812(c) "can be identified as having been received by the decedent from \* \* \* such prior decedent by gift, bequest, devise or inheritance".<sup>4</sup>

If that is what Congress intended would it not have been simple to have said that the property previously taxed should be the net equity acquired from the prior decedent? The constant repetition of the reference to "gross estate" must in itself be conclusive in establishing that Congress intended by *unmistakable* terms, to set out exactly how this deduction was to be computed and what factors were to be used. If the reference to "*gross estate*" is to be ignored then what will be done about the requirement in the first sentence of the fourth paragraph of Sec. 812(c) that "where a deduction was allowed of any mortgage or other lien in determining the \* \* \* estate tax of the prior decedent, which was paid in whole or in part

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<sup>4</sup>The inconsistency of Government's contention with its computations as to the previously taxed property included in Thomas' estate is pointed out in footnote 2 *supra*.

prior to the decedent's death, then *the deduction allowable under this subsection shall be reduced by the amount so paid*''? (Italics supplied.) If the "deduction allowable under this subsection" is only the net equity, then this particular provision has no purpose or function because the literal application of the sentence would require a second reduction for the amount of the mortgage and such a result makes no sense whatever. Obviously, that provision acknowledges that the initial identifiable value of the property is its gross estate value in the prior estate and since the mortgage had been allowed as a deduction it is necessary to reduce the initial identifiable value by the amount of the mortgage to prevent the allowance of a deduction for property previously taxed greater than the net value at which the property was previously taxed in the prior estate.

Again, if the reference to "*gross estate*" throughout the Section is to be ignored, then what will be done about the requirement in the third sentence of the fourth paragraph of Section 812(c) that

"if the property includible in the gross estate to which the deduction is attributable is not wholly property subject to general claims—(1) before the application of the preceding sentence, the amount of the deduction under this subsection shall be reduced by that part of such amount as the value, at the time of decedent's death, of such property (to which such deduction is attributable) subject to claims but not to general claims is of the value, at the time of the decedent's death, of such property, and \* \* \*

Obviously, since the only part of the property which would not be subject to general claims would be that part encumbered by liens or charges, the Statute acknowledges that the "deduction" before application of the above quoted sentence, could be the gross estate value before reduction for the amount of the liens or charges. The very purpose of this provision is to reduce the gross estate value of the property previously taxed by those charges or liens against the property (thus eliminating the possibility of a double deduction for the liens and charges which are separately allowed as deductions under Sec. 812(b)(4)), and because the "deduction" before application of this provision, may be a different amount than the amount at which the property is includible in the gross estate of the decedent,<sup>5</sup> Congress evidently concluded that the use of the proportionate formula produced a fairer result than if the liens and charges were eliminated in full. Lines (g) and (h) in the schedule which is submitted in the Appendix hereto as Appellant's understanding of how the property previously taxed reduction should be determined, illustrates how this formula reduction is computed. If as the Government contends, the "property includible in the gross estate to which the deduction is attributable" was intended to refer merely to the net equity (the gross estate value of the property less the liens and charges), then

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<sup>5</sup>This is true in this case where the identifiable gross estate value of the property in Thomas' estate was \$585,719.23 whereas the identifiable gross estate value of the property in Peter's estate was \$577,971.92 so the "deduction" before application of this sentence was \$577,971.92 the lesser of the two valuations.

this particular provision would have no purpose or function.

The adoption of the Government's contention would require a complete disregard of the use in the Statute, Section 812(c), of the term "includible in the gross estate" and of the term "gross estate", and also complete disregard of the fourth paragraph of Section 812(c). One of the earliest accepted rules of statutory construction is that when the words of a statute are plain and unambiguous, there is no room for construction and nothing is left for the Court but to give them their full effect. (*The Samuel E. Spring* (1886), 27 Fed. 764.) In *Gould v. Gould* (1915), 245 U.S. 151, the U. S. Supreme Court admonished that "in the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matter not specifically pointed out". (Also *Commissioner v. Van Vorst*, (C.A. 9, 1932), 59 F.2d 677.)

The exhibit in the Appendix hereto shows exactly how Section 812(c) is self operating to produce fair results through the adjustments provided for in the fourth paragraph thereof. There is no need to resort to theoretical assumptions as to what should be done under Section 812(c)—if the wording of the Section is given its clear meaning, and if it is applied in compliance with that meaning, the answer must be a fair determination of the property previously taxed deduction as Congress intended it.



The language of the Statute calls for the use of the value at which the particular property was included in the "gross estate". This does not mean some "theoretical balance" or "net equity". There is no mystery or ambiguity over the term "gross estate". The stipulation and the findings of the District Court show the values at which the property was included in the "gross estate"—\$577,971.92 in the gross estate of Peter McDonough, and \$585,719.23 in the gross estate of Thomas (assuming Appellant is correct that the lien is not to be applied as a reduction of the fair market value at which the property must be included in the "gross estate", but should be reported as a "deduction" from the gross estate in arriving at the net taxable estate as argued in Appellant's opening brief pages 17 to 19). These then are the amounts which should be recognized as the initial identifiable valuations of the property previously taxed to be used in the determination of the property previously taxed deduction.

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#### CONCLUSION.

It is respectfully urged that this Honorable Court should (1) insist upon strict application of the wording of Section 812(c), and (2) rule that the basic valuations to be used in computing the property previously taxed deduction should be the valuations at which such property was included in the gross estate of the decedents,—\$577,971.92 as the value included in the gross estate of Peter McDonough, and \$585,719.23 as the value includible in the gross estate of

Thomas McDonough—and (3) reverse the decision of the District Court and remand the case to said Court for a determination of the proper estate tax in accordance with the reversal and for computation of the necessary adjustments required by the fourth paragraph of Section 812(c) for the determination of the property previously taxed deduction.

Dated, San Francisco, California,

February 28, 1956.

Respectfully submitted,

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(Appendix Follows.)





## **Appendix.**



## Appendix

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### ESTATE OF THOMAS McDONOUGH.

#### COMPUTATION OF DEDUCTION FOR PROPERTY PREVIOUSLY TAXED.

(a) Total of PPT included in Thomas gross estate Sch. 1 total of applicable cols. A or C Tr. par. 5, p. 24	\$ 585,719.23 <hr/> <hr/>
(b) Gross PPT deduction (Total of Col. C or Total of Col. E whichever is lower) (E—Finally determined value in previous estate—Tr. par. 4(b), p. 23)	\$ 577,971.92
(c) Less amount paid prior to decedent's death on mortgages or liens <i>deducted</i> in prior estate as gift	None <hr/>
(d) "Amount otherwise deductible" for PPT without proportionate deduction (b minus c)	\$ 577,971.92
(e) Liens on PPT: Mortgages, real estate taxes or collateral loans Fed. Est. Tax on Peter's estate paid by Thomas' estate (Tr. par. 4(e) and (f), p. 24)	None    \$141,592.71 <hr/>
(f) Total of liens on PPT	\$ 141,592.71 <hr/> <hr/>
(g) First proportionate limitation: (f) $\frac{\$141,592.71}{\$585,719.23}$ X (d) \$577,971.92 =	(g) \$ 139,695.59 <hr/> <hr/>
(h) "Amount otherwise deductible" after first limitation (d minus g)	\$ 438,276.33 <hr/>
(i) Total of PPT included in gross estate (Same as (a))	\$ 585,719.23

(j) Reduce PPT to amount available for payment of general claims by deducting Mortgages, liens, real estate taxes and exempt assets		None
Fed. Est. Tax on Peter's estate paid by Thomas' estate	\$141,592.71	
Total	\$141,592.71	\$ 141,592.71
(k) PPT available for payment of general claims (i minus j)		\$ 444,126.52
(m) Proportion to determine "amount otherwise deductible" for purposes of computing the further reduction:		
(k) $\frac{\$444,126.52}{\$585,719.23}$	X (d) \$577,971.92 =	(m) \$ 438,217.61
(i) $\frac{\$444,126.52}{\$585,719.23}$		
(n) Value of gross taxable estate (	\$1,074,213.54)	
	(plus \$141,592.71)	\$1,215,806.25
(o) Items not available for payment of general claims Assets not subject to general claims— Fed. Est. Tax on Peter's estate paid by Thomas' estate		\$ 141,592.71
(p) Gross estate subject to payment of claims (n minus o)		\$1,074,213.54

## FOR BASIC TAX

(q) Total deduction from gross estate, including specific exemption and excluding PPT		\$308,628.37
Less: Fed. Est. Tax on Peter's est. paid by Thomas' Est.	\$141,592.71	(r) \$167,035.66
"Amount otherwise deductible" after first limitation (same as h)		(h) \$438,276.33
(s) Second proportionate limitation:		
(m) \$ 438,217.61	X (r) \$167,035.66 =	(s) \$ 68,133.58
(p) \$1,074,213.54		
(t) Net deduction for PPT—basic tax (h minus s)		\$370,142.75

## FOR ADDITIONAL TAX

(u)	Total deductions from gross tax- able estate, excluding PPT	\$268,628.37	
	Less: Fed. Est. Tax on Peter's est. paid by Thomas' Est.	\$141,592.71	(v) \$127,035.66
	"Amount otherwise deductible"		
	after first limitation (same as h)		(h) \$438,276.33
(w)	Second proportionate limitation:		
(m)	\$ 438,217.61		
(p)	\$1,074,213.54	X (v) \$127,035.66 =	(w) \$ 51,817.98
(x)	Net deduction for PPT—Additional tax		
	(u minus w)		\$386,458.35

Deduction allowed by Government and approved by District Court:

For basic tax	\$315,755.73
For additional tax	\$329,678.28

